Free-trader turned game-changer

Peter Navarro is about to become one of the world’s most powerful economists

There are reasons to be worried about the head of Donald Trump’s new National Trade Council

Jan 21st 2017 | Washington, DC


EPA Ready to rock

THE day after Ronald Reagan won his second term as president in 1984, a doctoral student at Harvard University published his second book. “The Policy Game: How Special Interests and Ideologues are Stealing America” complained that greedy interest groups and misguided ideologues had led America to “a point in its history where it cannot grow and prosper”. The solution: increase political participation and swap ideology for pragmatism.

On January 20th that student, now a professor, will enter the White House as part of a populist insurgency. Peter Navarro, a China-bashing eccentric who will lead the new National Trade Council, has emerged as the brains behind Donald Trump’s brawn on trade. Lauded as a “visionary” by Mr Trump, Mr Navarro may soon be the world’s most powerful economist working outside a central bank.

He once supported free trade. An entire chapter of “The Policy Game” extols its virtues, labelling the protectionism of Reagan, who coerced the Japanese into reducing their car exports in 1981, as "dangerous and virulent". There was a hint of his later scepticism: he called for more compensation for workers who lose their jobs to foreign competition, and stricter trade rules at the supranational level. But one benefit of such rules, he wrote, would be to provide presidents with an "escape from domestic protectionist pressures…the issue would be out of their hands."

It seems that Mr Navarro's change of heart came decades later, after he took an interest in China. (Like other members of the incoming administration, he has been unavailable for interview in advance of the inauguration.) His road to China was a long and winding one: his research interests are broader than the average economist's. His doctoral thesis studied the reasons firms give to charity; his paper on this remains his most cited work. He has worked extensively on energy policy. In 2000 or so he began studying online education, and was an early adopter of technological aids in his own teaching, says Frank Harris, one of his former students.

Two themes emerge from Mr Navarro's zigzagging research, which, since 1989, he has pursued at the University of California, Irvine. The first is a preference for real-world issues over abstraction. In 2000 he wrote two papers with Mr Harris on the best way to develop wind energy. Just months after the attacks of September 11th 2001 he tried to calculate their economic costs. He has written a popular book about investing, "If It's Raining in Brazil, Buy Starbucks". He is a prolific writer, but has no publications in top-tier academic journals.

The second theme is his interest in the distribution of income. But whereas the fortunes of rich and poor have gripped other economists, Mr Navarro has "always been focused on a broad swathe of the middle", says Richard Carson, a co-author. (Mr Carson worked with Mr Navarro on a paper arguing that the growth of cities should be tied to quality-of-life measures, such as traffic levels and school overcrowding.) Such concerns helped to draw Mr Navarro into politics. In the 1990s he ran for office several times as a Democrat, losing every race. He seems to be enjoying his political comeback: his television appearances can deteriorate into rumbustious shouting matches. He is fond of hyperbole. When he sends e-mails, his screen name appears as "ComingChinaWars".

It is his recent work on China that led to his unlikely hiring by Mr Trump. In the past decade or so Mr Navarro has penned three books warning darkly of the dangers posed by China's economic and military rise. The second, "Death by China", became a documentary in 2012. Narrated by Martin Sheen, an actor and left-wing icon, the film tours communities that have suffered from competition with Chinese imports, juxtaposing shuttered American factories with shots of Chinese sweatshops.

The core allegations Mr Navarro makes against China are not all that controversial. He accuses China of keeping its currency cheap, a common charge until 2015, when China began intervening in currency markets in the opposite direction. He deplores China’s practice of forcing American firms to hand over intellectual property as a condition of access to its market. He notes, correctly, that Chinese firms pollute the environment more freely and employ workers in far worse conditions than American rules allow, and produce exports which often benefit from government subsidies.

Trading positions

A charitable interpretation of his views is therefore that he is not a protectionist at all. Rather, he simply objects to mercantilism on the part of the Chinese. In 2006 he estimated that 41% of China’s competitive advantage over America in manufacturing stemmed from unfair trade practices. In interviews he has noted the similarity between this figure and the 45% tariff Mr Trump threatens to levy on Chinese goods.

But this interpretation does not explain Mr Navarro’s oddest views, like his opinion of the trade deficit. After China joined the World Trade Organisation in 2001, the trade deficit exploded at the same time as millions of manufacturing jobs vanished (see chart 1). Mr Navarro claims that, as a matter of arithmetic, unbalanced trade is responsible for a slowdown in growth since 2000. Mr Trump spouts similar lines, talking about the trade deficit as if it were simply lost American wealth.

This is dodgy economics. A deconstruction of spending in the economy shows exports as a positive and imports as a negative. But the same accounting exercise also shows government spending as a component of GDP. Few economists—and certainly few Republicans—would say that the bigger the government, the richer the economy in the long-term. The equation shows how resources are used, not produced.

Were Americans unable to buy cheap imports, they would be poorer, with less to spend on other things. They would also be less specialised, and hence less productive, at work. Lawrence Edwards and Robert Lawrence, two economists, estimate that, under certain assumptions, by 2008 trade in manufactured goods put $1,000 in the pockets of every American. China accounted for about a quarter of that amount. Recent work by the Council of Economic Advisers has shown that trade barriers, by raising the price of goods, tend to hurt the poorest most (see chart 2). If China exploits its workers and pollutes its rivers so that poor Americans can enjoy cheaper goods, it is not obvious that America is getting a raw deal.

Trade balances result primarily from saving-and-investment patterns. When capital flows in one direction, goods and services flow in the other. China’s trade surplus with America during the 2000s was a consequence mainly of the Chinese buying Treasury bills, says Gordon Hanson, a trade specialist at the University of

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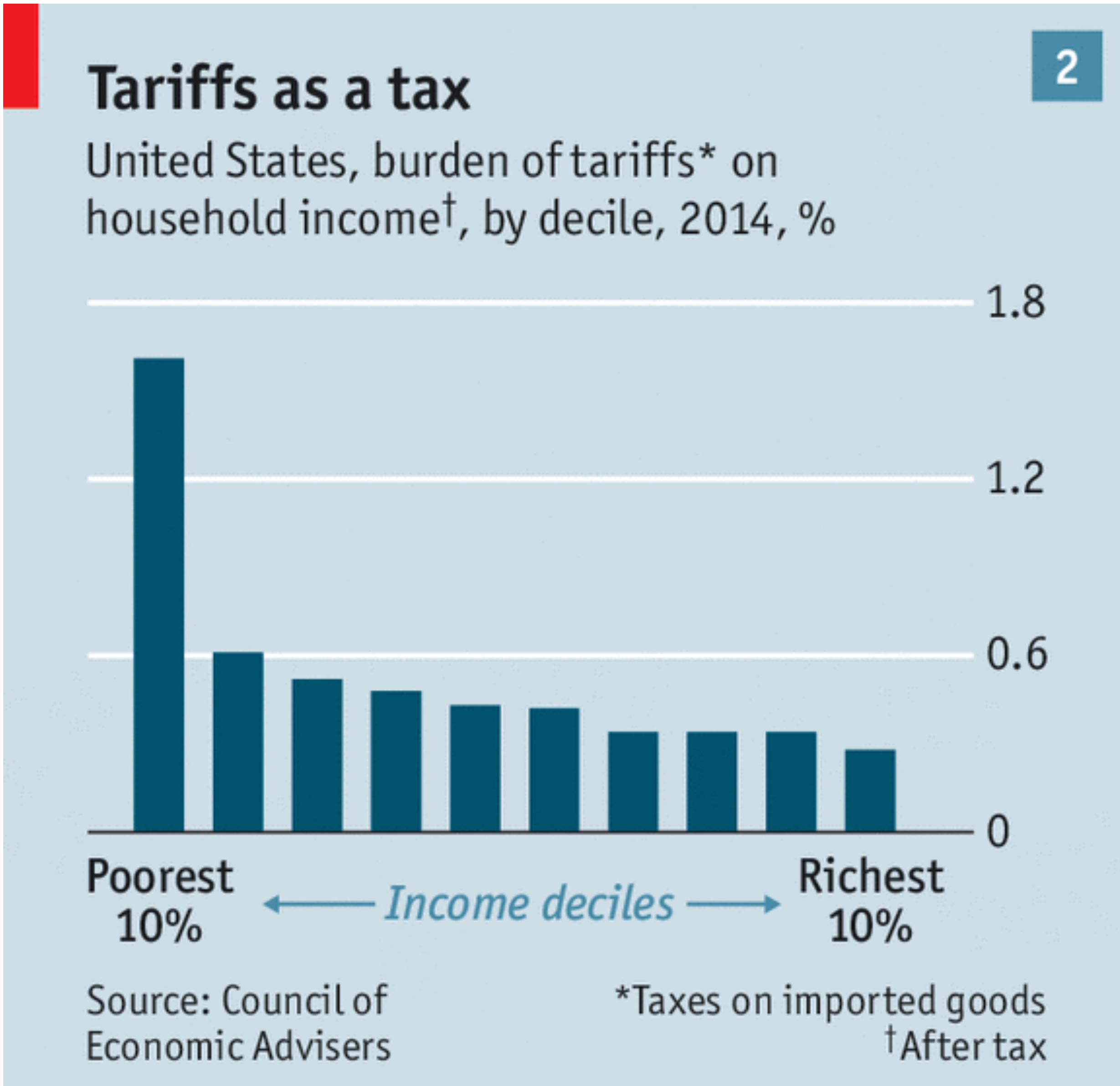
California, San Diego. This was not necessarily benign. Ben Bernanke, a former chairman of the Federal Reserve, suggested in 2005 that it contributed to a "global saving glut". Mr Navarro sometimes hints at this more nuanced view. A book he wrote in 2010 with Glenn Hubbard, a more mainstream Republican economist, argued that "Asia saves too much and the United States consumes too much." Yet Mr Trump's plan for tax cuts and infrastructure spending, by pushing up government deficits, would make this problem worse.

What might Mr Navarro recommend in office? He and Mr Hubbard say that China should be subject to "appropriate defensive measures". That probably means more than the retaliatory duties already imposed on some Chinese goods. Mr Navarro says that Mr Trump is merely threatening an acrossthe-board tariff, in order to exact



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concessions from the Chinese. He seems to think that once they comply with global trade rules, the trade deficit will close and manufacturing jobs will return to America's shores: "The best jobs programme...is trade reform with China."

This is a fantasy. When manufacturing production moves overseas and then returns, productivity has usually risen in the interim; so far fewer jobs come back than left. Messrs Edwards and Lawrence find that even though the trade deficit in manufactured goods in 2010 was about two-and-a-half times what it was in 1998, the number of lost manufacturing jobs the deficit represented rose only very slightly, from 2.5m to 2.7m. In any case, if China lost low-skilled jobs, manufacturers would relocate to other low-cost emerging economies, not America, says Eswar Prasad of the

Brookings Institution, a think-tank.

That means neither fairer play by China nor tariffs could help many American workers. More productive strategies are available. David Dollar, also of Brookings, has set out how a country could play "responsible hardball" with China. He recommends restricting the acquisition of American firms by China's state-owned enterprises, something the Obama administration cautiously started doing. Such investment flows represent artificially high Chinese savings rather than the invisible hand of the market. Until now China has invested mainly in Treasury bonds. But it is increasingly interested in buying American technology firms. With restrictions imposed, America could demand that China open up more of its services market.

What about environmental and labour standards? The best way to improve those, argues Mr Prasad, would be to write trade deals including rules which China will eventually have to follow. This was one aim of the doomed Trans-Pacific Partnership. It is a more realistic goal than returning low-skilled work to America en masse.

It is possible that, in office, Mr Navarro will lean towards these kinds of ideas. But there is no sign of it yet: he recently promised "a seismic and transformative shift in trade policy". Another change of opinion on trade might be too much to hope for. A man who has waited 32 years for a revolution has probably made up his mind.

This article appeared in the Briefing section of the print edition under the headline "Free-trader turned game-changer"